The 2017 National Defense Authorization Act (NDAA), also known as Public Law 114-328, required the Department of Defense to change the way it managed contractor IR&D and B&P expenses. Section 824 required:

- Contractor IR&D expenses allocated to DoD contracts must be reported separately from other contractor indirect expenses

- The current limitations found in the DFARS IR&D/B&P cost principle, that limits allowable costs to those found to be of interest to the DoD (via one of seven possible avenues) were eliminated in favor of “a CEO determination that IR&D expenses will advance the needs of DoD for future technology and advanced capability.”

- Existing DFARS cost principle language governing B&P cost allowability, which seemed to imply that contractor B&P expenses must also be of interest to DoD, was revised to eliminate that requirement

- In addition, contractor B&P expenses allocated to DoD contracts must be reported separately from other contractor indirect expenses.

- The DCAA must revise its Annual Report to Congress format to provide—

- a summary, set forth separately by dollar amount and percentage, of indirect costs for independent research and development incurred by contractors in the previous fiscal year

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a summary, set forth separately by dollar amount and percentage, of indirect costs for bid and proposal costs incurred by contractors in the previous fiscal year

Link to the 2017 NDAA language **here** .

Importantly—

Regulations prescribed under subsection (a) may not include provisions that would infringe on the independence of a contractor to choose which technologies to pursue in its independent research and development program if the chief executive officer of the contractor determines that expenditures will advance the needs of the Department of Defense for future technology and advanced capability as transmitted pursuant to subsection (c)(3)(A).

Now, in 2021, the DAR Council has **promulgated** a proposed rule to implement the 2017 NDAA requirements. Let's look at it. The proposed rule—

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Adds language at DFARS 231.205-18(c) to require contractor CEOs to determine that IR&D expenditures will advance the needs of DoD for future technology and advanced capability.

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Adds a requirement for major contractors to include a statement in their submission to the Defense Technical Information Center (DTIC) that the CEO of the contractor has made the determination required by 10 U.S.C. 2372. This statement serves as evidence for DoD, when determining whether IR&D costs are allowable. The proposed rule notes that major contractors are already required to upload IR&D activities in DTIC in order to provide DoD with information on the progress of these activities; so this rule adds a requirement for those major contractors to include a statement in the DTIC input that the CEO determination has been made.

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Since the list of seven activities of potential interest to DoD was deleted, the requirement for the DCMA ACO to compare the IR&D activities uploaded in DTIC to the list of seven IR&D activities of potential interest to DoD no longer exists. Therefore, DFARS 242.771-3(a) is proposed to be modified to remove DCMA responsibilities for determining if an activity is of potential interest to DoD.

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Adds language to clarify that IR&D and B&P costs will be reported independently from other incurred indirect costs in a new paragraph at DFARS 231.205-18(c)(iv).

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Decouples IR&D and B&P by stating “IR&D *and* B&P” instead of “IR&D/B&P” throughout the text. However, for the purposes of calculating the threshold that requires major contractors to submit IR&D activities and statements regarding the CEO determinations in DTIC, the rule does not change the calculation, which combines IR&D and B&P, to ensure the definition of “major contractor” remains the same.

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DFARS 242.771-3(c)(1) is proposed to be modified to change the content of the communication from DoD to contractors from the “planned or expected DoD future needs” to the “planned or expected needs of DoD for future technology and advanced capability.” In addition, the responsibilities of the Office of the Under Secretary of Defense for Research and Engineering are expanded to include providing on the DTIC website communities of interest on DoD's future needs. An email address for additional information is also provided.

Importantly, the proposed rule adds a contract clause at DFARS 252.242-70XX, Independent Research and Development and Bid and Proposal Incurred Costs, ***which requires all contractors with noncommercial awards exceeding the simplified acquisition threshold to provide an incurred cost submission of IR&D and B&P costs for the prior Government fiscal year to a website for DCAA to access.***

We've thought about that final requirement. Why couldn't the DAR Council just modify the Allowable Cost and Payment contract clause (52.216-7) to require an additional schedule in the contractor's annual proposal to establish final billing rates? After all, there are already about two hundred zillion schedules; what's one more? But then we realized that many defense contractors don't have any cost-reimbursable or T&M contracts; they are 100% FFP contractors—especially the smaller subcontractors. If the DAR Council simply modified the 52.216-7 clause, then many defense contractors wouldn't be reporting their IR&D and B&P expenditures. Thus, the new contract clause makes a kind of sense, given Congressional direction.

If implemented as a final rule, the proposed language will require almost all defense contractors to submit an incurred cost submission. Some will be submitting their final billing rate proposals (which are *not* incurred cost submissions, but whatever) as they have always done. Now they will have an additional (real) incurred cost submission to submit for their B&P and IR&D project expense detail. So they will have *two* annual submissions to make. Other defense contractors, who have not had to submit anything before, will now have to submit one—the B&P and IR&D incurred cost submission.

Fun times ahead!

And what will DCAA do with the new submissions they receive? According to the Public Law and the proposed rule, they will have to aggregate the data and report summary-level statistics to Congress each year. Will the auditors want to use those submissions as audit leads? Well, they're not supposed to—but we'll have to see. Historically, DCAA as an agency has a rather poor record of resisting temptation to use information received for one thing as an audit lead for something else. But we can be optimistic, right?

Another thing that occurs to us is that there will need to be a standard submission format. If DCAA lets contractors do their own thing, then they'll have trouble aggregating the data they receive. The current language of the (draft) contract clause is fairly permissive. It states—

… the Contractor shall—

(1) Report to [website TBD] a consolidated spreadsheet of all independent research and development (IR&D) and bid and proposal (B&P) costs incurred by the Contractor during performance of any DoD contract in the previous fiscal year, beginning October 1 through September 30; and

(2) Submit this report no later than December 31 of each year.

(b) IR&D and B&P incurred costs shall be reported separately and shall be reported by costs attributable to—

(1) The Department of Defense (non-foreign military sales);

(2) Foreign military sales; and

(3) Other.

We're going out on a limb here, and will bet the existing permissive language becomes more prescriptive when the rule is finalized. The proposed clause language is also ambiguous, conflating the government fiscal year with a contractor fiscal year. Finally, the proposed language requires submission by 31 December but the (for a calendar year contractor), final costs won't be known for at least six months after that date. We'll also bet some of those details are caught in the final rule. At least, we hope they will be. You can help make that happen by submitting comments, which are due by not later than 29 November. The address for submission of comments is found in the proposed rule.

In summary, there are going to be a lot of defense contractors who now have to submit the new IR&D and B&P incurred costs reports. Many of them will have never submitted an incurred cost report before. We predict confusion. And perhaps more work for government contract accounting consultants.